Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, D.C. 20554

In the Matter of	)	
Federal-State Joint Board on Universal Service	)	CC Docket No. 96-45

REPLY COMMENTS OF VERIZON

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CONTENTS

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Introduction and Summary

The Joint Board should recommend that the $1.1 billion rural high-cost support program be reformed to ensure that all carriers receive sufficient, but not excess, levels of universal service support. As a step towards that end, it should recommend that all carriers serving rural areas with more than 100,000 lines in a state be transitioned to the same high-cost mechanism as other non-rural carriers. The continued effort by some commenters to lump all rural carriers – regardless of size or scope – into one monolithic group undermines the central tenets of the Rural Task Force that one-size-fits-all solutions are both inappropriate for rural carriers and counterproductive as universal service policy. Carriers with more than 100,000 lines in a state do not share the same operational characteristics of smaller rural carriers, and should instead be receiving the same level of funding as their non-rural counterparts.

Taking this step should be one component in a larger reform of universal service. As the Joint Board has recently recognized, the Commission must act "to preserve the sustainability of the universal service fund."[1] Other near-term steps necessary to control the rapid growth of the high-cost fund include modification of the current support mechanism by freezing rural high-cost loop support and limiting the number of competitive ETCs eligible to serve rural areas. *See Verizon Comments* at 14-16; *see also Comments of Verizon*, CC Docket No. 96-45 (filed Aug. 6, 2004).

I. The Joint Board Should Recommend That All Study Areas In A State Be Consolidated, And That Carriers With More Than 100,000 Lines In A State Receive Support Under the Non-Rural Mechanism

As the Commission recognized, "[b]y operating in multiple study areas in a given state, certain carriers may receive more high-cost universal service support than they would if their study areas within the state were combined."[2] To avoid such inequities, the Joint Board should require carriers to consolidate all study areas within the state for purposes of determining the appropriate levels of universal service support. *See Verizon Comments* at 5-8. Because carriers serving 100,000 lines or more within the state are more like non-rural carriers than smaller rural carriers, with economies of scale and efficiencies not realized by the smaller rural carriers for whom the rural support mechanism was designed, they should receive support under the non-rural support mechanism. *Id.*, at 8-14. In addition, the use of average, statewide rates allows carriers with a significant number of lines in a state to maintain reasonable comparability between urban and rural rates through the use of rate rebalancing. *See NASUCA Comments* at 8-

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1 *See Federal-State Joint Board on Universal Service*, Recommended Decision, FCC 04J-1, ¶ 3 (Feb. 27, 2004) ("*Portability Recommended Decision*"); *see also id.*, ¶¶ 62-68.

2 *Federal-State Joint Board on Universal Service*, Order, 19 FCC Rcd 11538, ¶ 12 (2004) ("*Referral Order*").

9.[3] By moving carriers with 100,000 lines or more to the appropriate level of universal service support, the Commission should eliminate cases in which carriers are receiving more support than is warranted, thus removing some of the sources of federal universal service fund growth.

Some commenters assert that the *Rural Task Force Order* does not expire by its own terms in June 2006, and thus it is not necessary to reform the fund now.[4] However, delay is not only inappropriate, but irresponsible. The Commission has correctly concluded that "[f]undamental changes … occurring in the industry, necessitate[] a thorough review of how to preserve and advance universal service." *Referral Order*, ¶ 7.[5] Central to that dynamic landscape is the continued growth of national and regional carriers serving rural communities through consolidation and acquisition. Equally significant is the rapid growth in the size of the rural high-cost fund that now totals $1 billion in annual support, excluding competitive ETC funding.[6] Just since the beginning of 2003, rural high-cost support has increased more than $118

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[3] As the Commission has recognized, there exist "substantial amounts of universal service support built into most state rate designs," and states are best suited to bearing the primary responsibility to ensure "reasonably comparable rates in rural and urban areas." *Federal-State Joint Board on Universal Service*, Order on Remand, Further Notice of Proposed Rulemaking, and Memorandum Opinion and Order, 18 FCC Rcd 22559, ¶ 22 (2003) ("*Remand Order*").

[4] *See USTA Comments* at 5.

[5] The *Referral Order* also states that it "is time to undertake a review of what measures should succeed the [five-year] RTF plan and, more generally how the rural and non-rural high-cost support mechanisms function together." *Referral Order*, ¶ 7; *Federal-State Joint Board on Universal Service*, Fourteenth Report and Order and Twenty-Second Order on Reconsideration, *Multi-Association Group (MAG) Plan for Regulation of Interstate Services of Non-Price Cap Incumbent Local Exchange Carriers and Interexchange Carriers*, Report and Order, 16 FCC Rcd 11244, ¶ 8 (2001) ("*Rural Task Force Order*").

[6] Industry Analysis Division, Wireline Competition Bureau, Federal Communications Commission, Federal-State Joint Board October 2004 Monitoring Report, Table 3.2 (rel. Oct. 2004)

million.[7] While rural commenters claim that increased funding to competitive ETCs is the source of growth for the high-cost fund,[8] and competitive ETCs instead place the blame entirely on rural LECs,[9] the fact is that finger-pointing will not solve the problem. Both sides are correct: the two most significant drivers of future universal service fund growth are rural incumbent LECs and competitive ETCs. Although carriers are right to point out that much of the growth, particularly to competitive ETCs, can be addressed in the ongoing *Portability Proceeding*,[10] that does not eliminate the need for reform of the rural high-cost mechanism. One commenter has calculated that more than $380 million per year is provided to carriers with more than 100,000 lines in a state.[11] To the extent that reform of the high-cost program can eliminate some of this

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7 *See NECA Comments* at 11 (table) (calculating $29.5 million in increased support to rural LECs, and $89 million in increased support to competitive ETCs, from 1Q2003 to 4Q2004). However, as many commenters have pointed out, much of the growth in ILEC support is due to the creation of new explicit universal service mechanisms. *See e.g.*, *id.*, at 10.

8 *See, e.g.*, *CenturyTel Comments* at 9 ("Based on current projections, funding to CETCs now exceeds half a billion dollars annually, approximately 7 percent of the high-cost fund – *and rising*") (emphasis in original); *OPASTCO Comments* at 6 ("Of all the rural universal service support projected to be received by CETCs in 4th Quarter 2004 ($105.6 million), approximately 24 percent is earmarked for CETCs with 100,000 or more connections in a state ($25.3 million). This is more than double the percentage of support going to rural ILEC study areas with 100,000 or more lines" (footnote omitted)); *NECA Comments* at 11 (noting that "over the past two years, the total cumulative increase in funding requirement for CETCs in rural study areas, in terms of actual dollars, is more than three times greater than the cumulative increase in funding requirement for the rural LECs").

9 *CTIA Comments* at 3-4, *Dobson Cellular Comments* at 3.

10 *See Portability Recommended Decision.*

11 *OPASTCO Comments* at 5-6 (estimating $69.8 million per quarter for rural ILECs, and $25.3 million per quarter for rural competitive ETCs). $69.8 million + $25.3 million per quarter x 4 quarters/year = $380.4 million per year.

funding as unnecessary, that reduces pressure on the universal service contribution factor, which is projected to increase significantly in the first quarter 2005.[12]

Similarly, the Joint Board should reject suggestions to delay consideration of a successor rural high-cost solution until a congressional rewrite of the Communications Act, or completion of the Commission's intercarrier compensation and portability proceedings. *NTCA Comments* at 6; *AT&T Comments* at 1; *GCI Comments* at 3-5. The fact that there exist other problems relating to universal service that need to be resolved by the Commission (or Congress) should not be an excuse for paralysis in reform of this fund.

A. Study Area Consolidation for Universal Service Purposes is Consistent with the Study Area Freeze and Universal Service Policies

The Commission established a study area freeze in 1984 "in order to prevent carriers from setting up high-cost exchanges within their existing service territory as separate study areas to maximize eligibility for high-cost universal service support."[13] Since that time, as a result of consolidation and acquisition, many carriers now serve multiple study areas within a given state, in contravention of the policies underlying that freeze.

In addition to maximizing the amount of high-cost support available to a carrier, rural consolidation – and the corresponding lack of the study area consolidation – also can result in carriers receiving support under the inappropriate high-cost support mechanism. For instance, a

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12 Proposed First Quarter 2005 Universal Service Contribution Factor, Public Notice, CC Docket No. 96-45, DA 04-3902 (Dec. 13, 2004).

13 *Federal-State Joint Board on Universal Service Seeks Comment on Certain of the Commission's Rules Relating to High-Cost Universal Service Support*, Public Notice, 19 FCC Rcd 16083, n.30 (2004) ("*Joint Board Notice*").

carrier serving two study areas with 80,000 lines each may be classified under the rural mechanism currently, but would be included (absent fitting into another category of rural telephone company) in the non-rural mechanism if the study areas were combined. Action to require study area consolidation for universal service purposes is overdue in order to ensure that such inconsistent results are eliminated and that all carriers receive support under the appropriate mechanism.

Commenters opposed to study area consolidation largely avoid discussion of the study area freeze policy and the underlying rationale for the freeze. The assertion by some commenters that if economies do exist they already "are properly reflected" under the rural mechanism is tangential to the central issue. *Sprint Comments* at 5; *Frontier and Citizens Comments* at 2; *TDS Comments* at 18. Even assuming that the rural fund could in some cases "properly reflect" joint operational costs, no carrier should be able to obtain – whether by happenstance or by design – different amounts of support than a similarly situated carrier simply because of artificial study area boundaries within a state.

Other parties focus on the potential for an increase in cross-subsidization of high-cost areas with low-cost areas resulting from a combination of study areas in a state. *Sprint Comments* at 6; *CenturyTel Comments* at 16. However, the Commission expressly has recognized that "Congress did not intend the Commission to federalize the dual federal/state universal service support system by converting implicit state subsidies to explicit federal subsidies and taking on the entire burden of providing support for intrastate costs in high-cost and rural areas." *Remand Order*, ¶ 21. Rather, "states retain primary responsibility for ensuring reasonable comparability of rates within their borders." *Id.*, ¶ 17. *Federal* universal service support only should be used in instances where states "do not have the resources within their borders to support all of their high-cost lines" – *i.e.*, for those states whose average costs are significantly higher than the national average. *Id.*, ¶ 21. Moreover, these commenters ignore that requiring study area consolidation would only place carriers in the same position as all other carriers consistent with the study area freeze policy. *Rural Task Force Order,* ¶¶ 110-112. Carriers would remain free to subsequently disaggregate and target support to the highest cost exchanges within a consolidated study area consistent with existing rules. *Id.,* ¶¶ 144-158; 47 C.F.R. § 54.315.

A number of parties further allege that an unintended consequence of study area consolidation, as well as the transition of carriers with over 100,000 lines to the non-rural fund, would be a "fire sale" of rural exchanges by affected carriers prior to the effective date of the new rules.[14] In reality, sales of exchanges are primarily driven by normal corporate profitability assessments, and this should continue to be the case. Overall, carriers would retain the incentive to spin-off study areas that do not effectively complement other holdings, and, in turn, acquire those properties that provide economies of scale and permit the clustering of service areas for operational efficiencies. Commenters have provided no policy justification to support maintaining a different set of universal service rules for rural consolidators operating in multiple study areas in a state than is applicable to similarly situated carriers.

[14] *ITTA Comments* at 14; *ACS Comments* at 6; *Frontier and Citizens Comments* at 3. ("create a perverse incentive to sell rural study areas or portions of rural study areas to smaller, higher-cost entities prior to the effective date of the changes").

B. Carriers Serving Rural Areas with More Than 100,000 Lines in a State Should Receive Support in the Same Manner as Similarly Situated Carriers

Commenters raise a number of objections to the transition of a discrete class of rural carriers to the non-rural mechanism. However, despite these objections, treating carriers serving rural areas in accordance with their circumstances, instead of adopting a cookie-cutter approach to all, is consistent with the Act, the findings of the *Rural Task Force*, and the clear-cut need for all similarly situated carriers to receive support under the same fund.[15] A 100,000-line threshold is the simplest and most effective means to distinguish between the different situations of carriers serving rural areas.

Section 254 of the Act outlines the principles that should guide the Commission's high-cost universal service policies, including the need for *consumers* in "rural, insular, and high-cost areas" to have access to services that are affordable and reasonably comparable to other areas, but is silent as to specific mechanisms to achieve those results for rural or non-rural carriers.[16] Importantly, Congress did not require rural telephone companies to receive universal service support pursuant to a specific mechanism.

As the Joint Board properly recognized, there is "no statutory requirement that the Commission use the Act's definition of rural telephone company for high-cost universal service purposes."[17] The Commission adopted separate high-cost support mechanisms for rural and non-rural telephone companies, as a convenient means to differentiate between those carriers that

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15 *See, e.g., USTA Comments* at 7.

16 47 U.S.C. § 254(b)(3).

17 *Joint Board Notice*, ¶ 9.

should receive support under a forward-looking cost mechanism, and those that should remain under an embedded-cost mechanism.[18] Based on the record in this proceeding and a more granular review of the Rural Task Force's studies, the Joint Board should revisit that dividing line, and more precisely define those carriers that should remain under the current rural mechanism.

Nevertheless, a number of commenters attempt to argue that the Commission is bound to use the same definition of "rural" in setting forth universal service support programs under Section 254 as is used in Section 214 of the Act.[19] However, the two sections of the Act serve separate purposes, and Congress specifically did *not* use the same definitions in these different sections. Section 214(e)(2) states that the Commission "shall" in areas served by a non-rural telephone company and "may" in areas served by "a rural telephone company," designate more than one ETC per service area. However, nothing in that section addresses what is the appropriate level of universal service support to be provided to carriers. Moreover, unlike Section 214, Section 254 does not reference requirements for areas served by a "rural telephone company." Instead, it simply states that *consumers* in rural areas should have access to services at rates reasonably comparable to consumers in urban areas. 47 U.S.C. § 254(b)(3).[20] Because carriers with more than 100,000 lines in a state enjoy efficiencies of scale unavailable to smaller

[18] *Federal State Joint Board on Universal Service*, First Report and Order, 12 FCC Rcd 8776, ¶¶ 216, 291 (1997).

[19] For example, ALLTEL claims that this issue is "inexorably tied to Section 214(e)." *ALLTEL Comments* at 5. Similarly, OPASTCO broadly states that the "Joint Board should not attempt to second-guess Congress," even though Congress did not direct or select the high-cost mechanisms used by the Commission. *OPASTCO Comments* at 4.

[20] *See* 47 U.S.C. § 254; *see also Verizon Comments*, at 9; *SBC Comments* at 4.

carriers, and additionally may have resources within the state to support high-cost lines with lower cost areas, federal rural high cost support is not necessary to make rates to consumers in those areas "comparable" to urban areas.[21]

Carriers with more than 100,000, lines do not belong in the rural support mechanism. *See Verizon Comments*, at 8-14. Some commenters arguing against this fact point to the general conclusions of the Rural Task Force, and its *Rural Difference* White Paper, which they argue supports the need for funding to rural carriers.[22] However, these commenters selectively gloss over the most pertinent findings of the Rural Task Force, which show that "data seem to show that some rural companies may be more similar to non-rural companies than to smaller rural companies."[23] They also ignore the Commission's subsequent recognition that there are "significant differences among rural carriers."[24] Bare reliance, therefore, on those characteristics

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[21] Further, the use of a total line threshold is appreciably superior to proposals to establish eligibility for the non-rural mechanism based on line density or other geographic definitions, which are unworkable because they are fraught with data collection, enforcement, and administrative problems. *ALLTEL Comment*s at 5; *SBC Comments* at 2-3; *Western Wireless Comments* at 32. Moreover, the Commission has highlighted in both the Schools and Libraries Program and the Rural Health Care Program proceedings that there is no simple definition of "rural," and that metrics based upon density, census zones, or other geographic units introduce significant uncertainty and complexity into the high-cost funds. *See Rural Health Care Support Mechanism,* Report and Order, Order on Reconsideration, and Further Notice of Proposed Rulemaking, 18 FCC Rcd 24546, ¶¶ 63-64 (2003); *Schools and Libraries Universal Service Support Mechanism,* Third Report and Order and Second Further Notice of Proposed Rulemaking, 18 FCC Rcd 26912, ¶¶ 67-69 (2003)

[22] *See, e.g., CenturyTel Comments* at 5; *NTCA Comments* at 5; *ITTA Comments* at 3-5.

[23] *Rural Task Force Order,* ¶ 172.

[24] *Rural Task Force Order*, ¶ 8. A number of parties also highlight the basic principle that larger carriers have different characteristics than small rural carriers. NASUCA notes that "the larger rural carriers for whom *The Rural Differenc*e data shows less of a difference from the non-rural carriers for which the forward-looking cost test has been implemented." *NASUCA Comments* at 26. The Regulatory Commission of Alaska also "question[s] whether study areas

of smaller rural carries that warranted the creation of a separate rural mechanism is misplaced with respect to carriers with more than 100,000 lines. *Verizon Comments* at 10-13.

Frontier and Citizens oppose a transition to the non-rural fund, arguing that it denies "a rural company high cost support," and that they would lose $53 million in annual support as a result of the transition. *Frontier and Citizens Comments* at 2, 4. Even if that estimate is true, the fact that certain carriers may receive less support under the non-rural mechanism than the rural one is not an argument *against* moving them to a non-rural support mechanism. As the Joint Board recently stated, "the sufficiency and predictability principles [of the Act] do not provide that cost recovery should be guaranteed for particular carriers."[25] If moving some carriers to the non-rural funding mechanism gives them less support than they have received in the past, that does not prove that the new level of support is not the most appropriate one. To the extent such a move results in less universal service funding to many carriers, it will have the benefit of reducing some of the pressure on the universal service fund.[26] Thus, the Joint Board should reject proposals that are simply designed to maximize or maintain a particular carrier's universal service fund receipts.[27] Of course, not all carriers will receive less support under the new

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approaching 100,000 access lines should be considered rural, as is provided for under 47 U.S.C. § 143(37)(C)," noting that "[c]ompanies with such large numbers of access lines might not fit the true characteristics of a rural carrier." *Regulatory Commission of Alaska Comments* at 4-5.

[25] *Portability Recommended Decision*, ¶ 65.

[26] If there is evidence that carriers will suffer significant hardship in transitioning to a lower level of support, the Joint Board could mitigate that situation by recommending that the transition to the new mechanism occur over a one or two year period of time, to allow carriers time to adjust to the new level of support.

[27] Sprint's proposal to use the actual costs of price cap carriers to determine support for rate-of-return carriers is a self-serving attempt to maintain its own current level of funding. *Sprint Comments* at 3-4 (proposing a "move towards forward-looking costs by benchmarking the

mechanism; two commenters have estimated that it could "lead to *higher* support" for some. *ITTA Comments* at 27 (emphasis added); *Iowa Telecom Comments* at 10-11.

Some commenters opposing a transition to the non-rural mechanism argue that a number of large rural properties receive no support under the current rural support mechanism, suggesting that no change is, therefore, necessary as the current rural mechanism is working effectively. *Sprint Comments* at 8; *Frontier and Citizens Comments* at 2. However, if these properties receive no support under the current mechanism, it is unclear on what basis these carriers object to a transition that could do no harm. Further, the fact that economies of scale can be reflected to some extent under the rural mechanism does not address the more fundamental failing of the current system, which gives different levels of support to similarly situated carriers and largely fails to reflect economies of scale for those carriers operating under separate study areas within a state.[28]

In addition, for every story of how the rural support mechanism may be working properly, there exists a countervailing story of potential abuse. For example, USA Today recently examined the universal service program and questioned whether it is good public policy to obligate substantial federal universal service funds for carriers that charge very low local rates.

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average costs incurred by rural rate of return ILECs against those incurred by similarly-sized, similarly-situated rural price cap ILECs"). This proposal would add layers of complexity will no clear benefit, and Sprint has offered only vague details as to how such a process could be implemented effectively.

28 Insular carriers have significantly different cost characteristics because of the unique and difficult challenges they can face in serving island territories. Therefore, a unique universal service mechanism needs to be adopted for non-rural insular carriers based on their unique characteristics. *See* Letter from Bradley K. Gillen, Counsel for Puerto Rico Telephone Company, Inc., to Marlene H. Dortch, Secretary, FCC, CC Docket Nos. 96-45, 00-256, 98-77, and 98-166 (dated Feb. 28, 2003, filed March 3, 2003).

The article reported that one rural carrier charges only $12.80 for local exchange service (compared to a nationwide average of $36),[29] and receives over $400,000 in annual federal universal service support, or roughly $100 per line. At the same time, this carrier also has over $4 million in available cash, and has invested over $7 million in affiliated companies.[30] Especially with this example in mind, the Joint Board should consider the Sprint suggestion that "the most efficient and competitively neutral way to control the size of the fund is … to reduce the *need* for explicit support by allowing more of the required revenue to come directly from the end user." *Sprint Comments* at 6.

29 Industry Analysis Division, Wireline Competition Bureau, Federal Communications Commission, Trends in Telephone Service, Table 3.2 (rel. May 2004) (citing average 2002 monthly consumer expenditures to local exchange carriers).

30 Paul Davidson, *Fees Paid by All Phone Customers Help Rural Phone Firms Prosper*, USA Today (Nov. 16, 2004).

Conclusion

For the foregoing reasons, the Commission should transition all carriers serving over 100,000 access lines in a state to the non-rural high-cost mechanism. Additional reforms to strengthen the operation of the rural mechanism for small carriers are also necessary, including capping rural high-cost support and limiting the number of eligible ETCs in rural areas.

Respectfully submitted,

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